INDEX

	Page
Opinions below	1
Jurisdiction	2
Question presented	2
Statute and regulations involved	2
Statement	2
Specification of errors to be urged	5
Reasons for granting the writ	6
Conclusion	7
Appendix	8

CITATIONS

Case:	
Helvering v. *Gowran*, No. 887, Oct. Term, 1936	6
Statute:	
Revenue Act of 1928, c. 852, 45 Stat. 791, Sec. 115	8–10
Miscellaneous:	
Treasury Regulations 74, Art. 628	10

137755—37

In the Supreme Court of the United States

OCTOBER TERM, 1936

No. —

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

ANNIE M. PFEIFFER

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

The Solicitor General, on behalf of Guy T. Helvering, Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Second Circuit entered in the above cause on February 23, 1937, reversing a decision of the Board of Tax Appeals.

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 67) is a memorandum opinion and therefore not officially reported. The opinion of the Circuit Court of Appeals (R. 85) is not yet officially reported.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on February 23, 1937 (R. 90). The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTION PRESENTED

1. Whether a dividend by a corporation in its own preferred stock, payable to holders of common stock, resulting in the alteration of the pre-existing proportionate interests of the stockholders in the two classes of stock, constitutes taxable income under Section 115 of the Revenue Act of 1928.

STATUTE AND REGULATIONS INVOLVED

The statute and regulations involved will be found in the Appendix, *infra*, pp. 8–10.

STATEMENT

The facts, as stipulated (R. 18–62) and as found by the Board of Tax Appeals (R. 67–69), are substantially as follows:

The William R. Warner Corporation, hereinafter called the Corporation, was organized in 1920 under the laws of Delaware, its stock at all times consisting of common and preferred. Each class of stock had a par value of $100 per share, but they were otherwise essentially different. (R. 67.) Dividends upon the preferred stock were never in default (R. 68).

The authorized capital of the corporation was increased several times by capitalizing earnings. (R. 68.) In 1928, the preferred stock was increased from $5,000,000 to $15,000,000, the common stock remaining at $10,000,000, par value. On December 31, 1928, the corporation distributed $5,000,000 par value of preferred stock *pro rata* to common shareholders, and on April 27, 1931, it distributed $2,500,000 shares in a like manner. Each share of preferred had a fair market value of $100 at the date distributed. (R. 68.) Taxpayer received 12,582 shares in the 1928 distribution and 6,291¼ shares in the 1931 distribution. There was no accumulation of unpaid dividends on the preferred stock on April 27, 1931. On December 29, 1931, the corporation redeemed with cash at par 8,500 shares of preferred stock, including 2,000 shares belonging to the taxpayer which she had received in the 1928 distribution. (R. 68.)

In her 1931 return, taxpayer reported a capital gain of $180,100 as resulting from the redemption of the 2,000 shares, deducting a basis computed for stock received as a stock dividend. The Commissioner, in determining the deficiency, eliminated the capital gain, and included as dividends $200,000 representing the redemption and $629,125 representing the dividend in preferred stock. (R. 69.)

The Board of Tax Appeals held that the stock dividend in question was subject to tax at the time of its receipt under Section 115 of the Revenue

Act of 1928. With respect to the redemption of 2,000 shares of stock in 1931, the Board held that since the stock was subject to tax as a dividend in 19 when it was received by the taxpayer, the redemption in 1931 was not essentially equivalent to the distribution of a taxable dividend within the meaning of Section 115 (g). The Board also held that the shares of stock sold in 1931 previously issued as a dividend in 1928 had a cost basis to the taxpayer of $100 each, and consequently that those shares were redeemed without gain or loss to the taxpayer at $100 each in 1931. (R. 69.)

On appeal to the court below taxpayer contended that the stock dividend declared in 1931 was not subject to tax under Section 115 (f) of the Revenue Act of 1928. The Government contended that the stock dividend in question was not within the scope of the term "stock dividend" in Section 115 (f) and therefore was subject to the income tax. In the alternative, it contended that at least $200,000 should be added to the taxpayer's income for 1931 on account of the redemption in that year of stock received by the taxpayer as a dividend in 1928, although it did not file a cross appeal from the decision of the Board. The Government did not ask the lower court to increase the deficiency found by the Board, but merely to uphold the deficiency *pro tanto*. The Government made an additional alternative argument, in the event that the court should reject the above-mentioned contentions, that

the redemption of the preferred stock during the taxable year was essentially equivalent to the distribution of a taxable dividend under Section 115 (g).

The court below held that the dividend in question was not subject to tax under the terms of Section 115 (f) of the Revenue Act of 1928 and refused to pass upon the question of the cost basis of the stock sold during the taxable year and previously issued as a stock dividend in 1928, on the ground that it was not raised before the Board nor decided by the Board, and refused to remand the case to the Board of Tax Appeals for a determination in regard to the application of Section 115 (g) to the circumstances of this case. Judge Learned Hand filed a dissenting opinion in which he said that a stock dividend representing income under the Constitution was subject to tax at the time it was received under Section 115 (f).

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that the stock dividend in question was not subject to tax at the time of its receipt under Section 115 (f) of the Revenue Act of 1928 although it represented income under the Sixteenth Amendment.

2. In failing to hold that Section 115 (f) applies only to stock dividends that do not constitute income under the Sixteenth Amendment.

3. In refusing to pass upon the question of the cost basis of the dividend stock sold during the taxable year and the application of Section 115 (g) to the sale of the dividend stock during the taxable year.

4. In holding that the question of the cost basis of the dividend stock sold during the taxable year was not raised before the Board of Tax Appeals.

5. In refusing to remand the case to the Board of Tax Appeals for a determination with respect to the application of Section 115 (g) to the circumstances of this case.

6. In failing to hold that the cost basis of stock previously issued as a dividend, which might have been taxed as income under the Sixteenth Amendment at the time of receipt, is nothing because it cost the taxpayer nothing.

7. In reversing the decision of the Board of Tax Appeals.

REASONS FOR GRANTING THE WRIT

1. The court below has decided, with one judge dissenting, that the term "stock dividend" in Section 115 (f) of the Revenue Act of 1928 (*infra*, p. 9) means *any* stock dividend, rather than only such stock dividends as do not constitute income under the Sixteenth Amendment. We submit that in this respect the court erred in deciding a very important question of Federal tax law. Since the same question is presented in No. 887, *Helvering* v. *Gowran*, in which a petition for a writ of certi-

orari to the Circuit Court of Appeals for the Seventh Circuit was filed on April 12, 1937, the Court is respectfully referred to that petition for a full statement of the reasons for granting a review of these cases.

2. We submit that the decision of the court below was also in error in refusing to pass upon and decide in favor of petitioner two alternative arguments, as to which error has been specified at p. 6, *supra*. It does not appear to be necessary to make a full argument as to those errors now.

CONCLUSION

Wherefore, it is respectfully submitted that this petition should be granted.

STANLEY REED,
Solicitor General.

APRIL 1937.

APPENDIX

STATUTE AND REGULATIONS INVOLVED

Revenue Act of 1928, c. 852, 45 Stat. 791, 822:

SEC. 115. DISTRIBUTIONS BY CORPORATIONS.

(a) *Definition of dividend.*—The term "dividend" when used in this title (except in section 203 (a) (4) and section 208 (c) (1), relating to insurance companies) means any distribution made by a corporation to its shareholders, whether in money or in other property, out of its earnings or profits accumulated after February 28, 1913.

(b) *Source of distributions.*—For the purposes of this Act every distribution is made out of earnings or profits to the extent thereof, and from the most recently accumulated earnings or profits. Any earnings or profits accumulated, or increase in value of property accrued, before March 1, 1913, may be distributed exempt from tax, after the earnings and profits accumulated after February 28, 1913, have been distributed, but any such tax-free distribution shall be applied against and reduce the basis of the stock provided in section 113.

(c) *Distributions in liquidation.*—Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock, and amounts distributed in partial liquidation of a corporation shall be treated as in part or full payment in exchange for the stock.

The gain or loss to the distributee resulting from such exchange shall be determined under section 111, but shall be recognized only to the extent provided in section 112. In the case of amounts distributed in partial liquidation (other than a distribution within the provisions of section 112 (h) of stock or securities in connection with a reorganization) the part of such distribution which is properly chargeable to capital account shall not be considered a distribution of earnings or profits within the meaning of subsection (b) of this section for the purpose of determining the taxability of subsequent distributions by the corporation.

* * * * *

(f) *Stock dividends.*—A stock dividend shall not be subject to tax.

(g) *Redemption of stock.*—If a corporation cancels or redeems its stock (whether or not such stock was issued as a stock dividend) at such time and in such manner as to make the distribution and cancellation or redemption in whole or in part essentially equivalent to the distribution of a taxable dividend, the amount so distributed in redemption or cancellation of the stock, to the extent that it represents a distribution of earnings or profits accumulated after February 28, 1913, shall be treated as a taxable dividend. In the case of the cancellation or redemption of stock not issued as a stock dividend this subsection shall apply only if the cancellation or redemption is made after January 1, 1926.

(h) *Definition of partial liquidation.*—As used in this section the term "amounts distributed in partial liquidation" means a distribution by a corporation in complete cancellation or redemption of a part of its

stock, or one of a series of distributions in complete cancellation or redemption of all or a portion of its stock.

Treasury Regulations 74, relating to the Revenue Act of 1928:

ART. 628. *Stock dividends.*—The issuance of its own stock by a corporation as a dividend to its shareholders does not result in taxable income to such shareholders, but gain may be derived or loss sustained by the shareholders from the sale of such stock. The amount of gain derived or loss sustained from the sale of such stock, or from the sale of the stock in respect of which it is issued, shall be determined as provided in articles 561 and 600.

U. S. GOVERNMENT PRINTING OFFICE: 1937